

THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

STAFF REPORT

OF THE

ACCOUNTING DEPARTMENT

AND

UTILITIES DEPARTMENT

DOCKET NO. 94-278-W/S

AAA UTILITIES, INC.

REPORT OF ACCOUNTING DEPARTMENT  
THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

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REPORT OF ACCOUNTING DEPARTMENT  
THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA  
DOCKET NO. 94-278-W/S  
AAA UTILITIES, INC.

SYNOPSIS

<u>Amount Requested</u>	\$	\$
<u>Phase 1</u>		
	<u>Water</u>	<u>Sewer</u>
Per Company-----	29,984*	420*
Per Staff-----	27,312*	420*
Percentage Increase-----	33.94%*	50.00%*

<u>Phase 2</u>		
	<u>Water</u>	<u>Sewer</u>
Per Company-----	26,683*	420*
Per Staff-----	26,716*	420*
Percentage Increase-----	24.79%*	33.33%*

Rate of Return on Rate Base

Per Books	( 24.46%)
As Adjusted	( 25.84%)
After Proposed Increase-Phase 1	18.06%
After Proposed Increase-Phase 2	55.38%

Operating Margin

Per Books	( 16.50%)
As Adjusted	( 23.59%)
After Proposed Increase-Phase 1	6.38%
After Proposed Increase-Phase 2	21.42%

\*The Accounting Department was furnished these figures by the Utilities Department.

REPORT OF ACCOUNTING DEPARTMENT  
THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

DOCKET NO. 94-278-W/S

AAA UTILITIES, INC.

ANALYSIS

The Accounting Department Staff has made a review of the Application of AAA Utilities, Inc. (hereinafter referred to as "the Company") along with certain of the Company's accounting records, relative to the Company's application for authority to increase certain rates and charges as shown in Docket No. 94-278-W/S.

The Accounting Department respectfully submits the results of its review as follows:

1. The Company filed an application on April 17, 1995 for approval of rates and charges for water and sewer provided to its residential customers.
2. This matter was set for public hearing on Wednesday, August 23, 1995 at 2:30 p.m.
3. The Company's principal place of business is at 1019 Reynord Circle, Columbia, South Carolina 29172.
4. The Company's application utilizes a December 31, 1994 test period and requests an increase in revenues of \$29,984 for water-Phase 1 and \$420 for sewer-Phase 1, \$26,683 for water-Phase 2, and \$420 for sewer-Phase 2.

The Accounting Department Staff's exhibits relative to the Company's proposed increase are as follows:

EXHIBIT A: OPERATING EXPERIENCE, RATE BASE, RATE OF RETURN, AND  
OPERATING MARGIN-WATER & SEWER

Shown in this exhibit are the Company's water and sewer operations for the twelve months ended December 31, 1994, with respect to Operating Experience, Rate Base, Rate of Return, and Operating Margin. The exhibit's format is designed to reflect per book information and applicable accounting and pro forma adjustments necessary to normalize the results of the Company's test year operations.

Staff verified the per book balances to the Company's books and records. The book figures reflect that the Company's water revenues totalled \$90,237 and sewer revenues totaled \$840, for Total Operating Revenues of \$91,077. Total Operating Expenses amounted to \$100,790 resulting in Net Operating Income (Loss) of (\$9,713). Total Income (Loss) for Return of (\$9,713) and Total Rate Base of \$39,702 produced a Rate of Return on Rate Base of (24.46%). Total Income (Loss) for Return of (\$9,713) less interest expense of \$5,314, and Operating Revenues of \$91,077 produced an Operating Margin of (16.50%).

Staff normalized the Company's operations by employing Adjustments #1 through #11. The net effect of the adjustments increased Total Income (Loss) for Return from (\$9,713) to (\$15,383) producing a Rate of Return on Rate Base of (25.84%) and an Operating Margin of (23.59%).

The Company has requested an increase in rates which would produce additional gross annual revenues for Phase 1 of \$27,312 for water and \$420 for sewer operations and for Phase 2, \$26,716 for water and \$420 for sewer operations. These figures were supplied by

the Utilities Department.

After the proposed increase, Phase 1, Water Revenues amounted to \$107,789 and sewer revenues amounted to \$1,260, for Total Operating Revenues of \$109,049. Operating Expenses amounted to \$98,532 which produced Net Operating Income (Loss) of \$10,517. Customer Growth of \$237 was added to this amount for Total Income (Loss) for Return of \$10,754. Total Income (Loss) for Return of \$10,754 and Total Rate Base of \$59,538 produced a Rate of Return on Rate Base of 18.06%. Total Operating Revenues of \$109,049 and Total Income (Loss) For Return of \$10,754, less interest expense of \$3,796, produced an Operating Margin of 6.38%.

After the proposed increase, Phase 2, Water Revenues amounted to \$134,505 and sewer revenues amounted to \$1,680, for Total Operating Revenues of \$136,185. Operating Expenses amounted to \$103,937 which produced Net Operating Income (Loss) of \$32,248. Customer Growth of \$726 was added to this amount for Total Income (Loss) for Return of \$32,974. Total Income (Loss) for Return of \$32,974 and Total Rate Base of \$59,538 produced a Rate of Return on Rate Base of 55.38%. Total Operating Revenues of \$136,185 and Total Income (Loss) For Return of \$32,974, less interest expense of \$3,796, produced an Operating Margin of 21.42%.

**EXHIBIT A-1: EXPLANATION OF ACCOUNTING AND PRO FORMA ADJUSTMENTS**

Shown in this exhibit are the details of each accounting and pro forma adjustment necessary to normalize the Company's water and sewer operations and to reflect the proposed increase. For comparative purposes, Company and Staff adjustments are both presented in this exhibit.

**EXHIBIT A-2: DEPRECIATION EXPENSE ADJUSTMENT**

Shown in this exhibit is Staff's annualized depreciation expense, with the total depreciable amount being reduced by Contributions in Aid of Construction. Staff annualized depreciation expense using rates supplied by the Staff's Utilities Department.

**EXHIBIT A-3: COMPUTATION OF INCOME TAXES**

Shown in this exhibit is the computation of income taxes using the composite tax rate of 19.25% (15% federal and 5% state).

**EXHIBIT A-4: COMPUTATION OF CUSTOMER GROWTH**

Total customers served during the test year increased from 390 to 409 producing a growth factor of 2.25%. Staff applied this factor to the Net Operating Income for water and sewer operations after the proposed increase.

**EXHIBIT A-5: COMPUTATION OF CASH WORKING CAPITAL**

Shown in this exhibit is the computation of the allowance for cash working capital using a forty-five (45) day lag from the time expenses are paid until revenues are received. The allowance per books totalled \$10,665 and as adjusted \$8,821.

**EXHIBIT A-6: RETURN ON COMMON EQUITY**

Shown in this exhibit is the Return on Common Equity computation before the proposed increase and after the total requested increase, Phases 1 and 2. This exhibit synchronizes interest expense with the debt portion of Rate Base. This ensures that the interest expense used to calculate the operating margin and income taxes is associated with the Rate Base and is not interest expense associated with debt to cover cash flow problems or to support non-utility related business activities.

The schedule shows that the Company's capital structure consists of \$32,118 for long-term debt and (\$23,452) for common equity. The negative equity creates an imbalance in the Company's capital structure by inflating the ratio for long-term debt and therefore inflating interest expense. The Commission Staff's Research Department has previously recommended that a 50/50 capital structure be used in these types of cases based on a survey of information from Value Line and Standard & Poor's reports. The 50/50 capital structure equally distributes the Rate Base between debt and equity. Using the 50/50 capital structure, the amount of income necessary to cover the embedded cost of debt amounts to \$3,796. Staff computed this amount by using the long-term debt portion of the Rate Base of \$29,769 and the embedded cost rate of 12.75%.

As shown on Exhibit A, Total Income (Loss) For Return before the requested increase totalled (\$15,383) and after the requested increase, Phase 1-\$10,754 and Phase 2-\$32,974. Therefore, (\$19,179) was available to common equity before the requested increase and \$6,958 for Phase 1, and \$29,178 for Phase 2, was available to common equity after the increase. These incomes (losses) produced a Return on Common Equity of (64.43%) before the proposed increase, and 23.37% for the Phase 1 increase and 98.01% for the Phase 2 increase.

EXHIBIT A-7: INCOME STATEMENT-FOR THE TEST YEAR ENDED DECEMBER 31, 1994

Income statement figures for the test year ending December 31, 1994 are reflected in this exhibit. Staff verified all balances contained in this statement to the Company's books and records.

EXHIBIT A-8: BALANCE SHEET-FOR THE TEST YEAR ENDED DECEMBER 31, 1994

Shown in this exhibit is the statement of financial position for the Company as of the end of the test year, December 31, 1994. Staff verified the balances contained in this statement to the Company's books and records.

AAA Utilities, Inc.  
Operating Experience, Rate Base, Rate of Return, and Operating Margin-Water & Sewer  
Test Year Ended December 31, 1994

(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Accounting and Pro Forma Adjustments	As Adjusted	Effect of Proposed Increase Phase 1	After Proposed Increase Phase 1	Effect of Proposed Increase Phase 2	After Proposed Increase Phase 2
Description						
<u>Operating Revenues</u>						
Water	\$ 90,237	( 9,760)(1)	80,477	27,312(12)	107,789	26,716(17)
Sewer	840	0	840	420(13)	1,260	420(18)
<u>Total Operating Revenues</u>	91,077	( 9,760)	81,317	27,732	109,049	27,136
<u>Operating Expenses</u>						
Operating	40,094	( 9,933)(2)	30,161	0	30,161	0
Maintenance	19,021	( 10,816)(3)	29,837	0	29,837	0
Administrative and General	26,201	( 1,551)(4)	24,650	0	24,650	0
Depreciation(A)	8,245	( 2,756)(5)	5,489	0	5,489	0
Amortization	1,734	( 1,630)(6)	104	0	104	0
Taxes Other Than Income	5,495	964(7)	6,459	230(14)	6,689	225(19)
Income Taxes (B)	0	0	0	1,602(15)	1,602	5,180(20)
<u>Total Operating Expenses</u>	100,790	( 4,090)	96,700	1,832	98,532	5,405
<u>Net Operating Income</u>	( 9,713)	( 5,670)	( 15,383)	25,900	10,517	21,731
Add: Customer Growth (C)	0	0	0	237(16)	237	489(21)
<u>Total Income For Return</u>	( 9,713)	( 5,670)	( 15,383)	26,137	10,754	22,220
<u>Rate Base</u>						
Gross Plant in Service	105,038	1,754(8)	106,792	0	106,792	0
Accumulated Depreciation	( 48,501)	( 2,756)(9)	( 45,745)	0	( 45,745)	0
<u>Net Plant in Service</u>	56,537	4,510	61,047	0	61,047	0
Add: Cash Working Capital (D)	10,665	( 1,844)(10)	8,821	0	8,821	0
Less: Contributions in Aid of Constr.	( 27,500)	17,170(11)	10,330	0	( 10,330)	0
<u>Total Rate Base</u>	39,702	19,836	59,538	0	59,538	0
<u>Rate of Return on Rate Base</u>	-24.46%		-25.84%		18.06%	
<u>Operating Margin (E)</u>	-16.50%		-23.59%		6.38%	

(A) Depreciation Expense Adjustment shown on Exhibit A-2.

(B) Computation of Income Taxes shown on Exhibit A-3

(C) Computation of Customer Growth shown on Exhibit A-4

(D) Computation of Cash Working Capital shown on Exhibit A-5.

(E) The Operating Margin reflects Total Income for Return less Interest Expense of \$5,314 on a per book basis, and \$3,796 on an as adjusted basis, and after Phase 1 and Phase 2 increases.

AAA Utilities, Inc.  
Explanation of Accounting and Pro Forma Adjustments  
Test Year Ended December 31, 1994

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Water	Operating	Maintenance	Administrative	Depreciation	Amortization	Taxes Other
Revenues							
\$		\$	\$	\$	\$	\$	\$

To adjust water operating revenues for year-end customers at present rates. (Utilities)

Per Staff 4,408  
Per Company 1,634

To remove DHEC pass-through fees from operating revenues. (Utilities)

Per Staff ( 11,288)  
Per Company 0

∞ To remove tap fees from operating revenues. (Utilities)

Per Staff ( 3,400)  
Per Company ( 2,400)

To add cut-on fees of \$420 and late charges of \$100. (Utilities)

Per Staff 520  
Per Company 0

To remove DHEC pass-through fees for the Drinking Water Act from operating expenses. The revenue and expense figures differ because the Company mistakenly included some of 1995 expenses instead of 1994 expenses. All of the pass-through expenses have been removed. (Acct.)

Per Staff ( 9,739)  
Per Company 0

AAA Utilities, Inc.  
Explanation of Accounting and Pro Forma Adjustments  
Test Year Ended December 31, 1994

Description	(1) Water Revenues	(2) Operating	(3) Maintenance	(4) Administrative & General	(5) Depreciation	(6) Amortization	(7) Taxes Other Than Income
	\$	\$	\$	\$	\$	\$	\$

To remove amount for overstatement of  
fuel account. (Acct.)

Per Staff ( 15)  
Per Company 0

To increase expenses for treatment  
chemicals, utilities, and supplies.  
Staff found no known and measurable  
changes to make this adjustment. (Acct.)

Per Staff 0  
Per Company 246

To remove cost for rebuilt pump.  
This expense should be capitalized.  
(Acct.)

Per Staff ( 179)  
Per Company 0

To remove cost for pump at Murray  
Hills. This expense should be  
capitalized. (Acct.)

Per Staff ( 1,200)  
Per Company 0

To remove costs associated with  
installing taps from operating  
expenses. These expenses should be  
capitalized. (Acct.)

Per Staff ( 375)  
Per Company 0

AAA Utilities, Inc.  
Explanation of Accounting and Pro Forma Adjustments  
Test Year Ended December 31, 1994

Description	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Water Revenues	Operating	Maintenance	Administrative & General	Depreciation	Amortization	Taxes Other Than Income
	\$	\$	\$	\$	\$	\$	\$

To remove out-of-period expenses from the test year. (Acct.)

Per Staff  
Per Company

(  
209)  
0

To increase president's salary and benefits to full-time status. Staff compared companies of similar size and found the Phase 1 salary and found the Phase 1 salary increase to be reasonable. (Acct.)

Per Staff  
Per Company-Phase 1  
Per Company-Phase 2

12,600  
12,600  
6,000

964  
964

To increase expenses for maintenance and repair of water systems to adequately maintain DHEC requirements. Staff found no known and measurable changes to make this adjustment. (Acct.)

Per Staff  
Per Company-Phase 1  
Per Company-Phase 2

0  
2,500  
2,500

To increase expenses for a full-time secretary/bookkeeper. Since the Company has not hired an employee for this position, Staff made no adjustment. (Acct.)

Per Staff  
Per Company

0  
3,000

AAA Utilities, Inc.  
Explanation of Accounting and Pro Forma Adjustments  
Test Year Ended December 31, 1994

(1) Water Revenues	(2) Operating	(3) Maintenance	(4) Administrative & General	(5) Depreciation	(6) Amortization	(7) Taxes Other Than Income
\$	\$	\$	\$	\$	\$	\$

To remove fines, penalties, and late fee from operating expenses. These expenses are considered nonallowable for ratemaking purposes. (Acct.)

Per Staff  
Per Company

(  
(

666)  
500)

To increase miscellaneous expenses. Staff found no known and measurable changes for this adjustment. (Acct.)

Per Staff  
Per Company

0  
7

To amortize one-time expense for the water billing system over three years. Staff proposes to normalize the test year. (Acct.)

Per Staff  
Per Company

(  
(

2,367)  
0

To amortize rate case expenses over over a three-year period. \$4,445/3 (Acct.)

Per Staff  
Per Company

1,482  
0

AAA Utilities, Inc.  
Explanation of Accounting and Pro Forma Adjustments  
Test Year Ended December 31, 1994

(1) Description	(2) Operating	(3) Maintenance	(4) Administrative & General	(5) Depreciation	(6) Amortization	(7) Taxes Other Than Income
Water Revenues						
\$	\$	\$	\$	\$	\$	\$

To annualize depreciation expense using rates recommended by the Utilities Department. Plant in service was reduced by contributions in aid of construction (tap fees) before depreciation expense was computed. (Utilities & Acct.)

Per Staff  
Per Company

( 2,784)  
0

To include depreciation for capitalized expenses associated with tap fees. (\$375 X 7.41%) (Acct.)

Per Staff  
Per Company

28  
0

To amortize organization costs associated with the utility plant acquisition. Staff used a rate of 4.00% to amortize costs. (Utilities & Acct.)

Per Staff  
Per Company

( 1,630)  
0

Total Revenue and Expense Adjustments--  
Per Staff

( 9,760)	( 9,933)	10,816	( 1,551)	( 2,756)	( 1,630)	964
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AAA Utilities, Inc.  
Explanation of Accounting and Pro Forma Adjustments  
Test Year Ended December 31, 1994

	(8)	(9)	(10)	(11)
	Plant in	Accumulated	Cash Working	Contributions In
	Service	Depreciation	Capital	Aid of Construct.
\$	\$	\$	\$	\$

To adjust plant in service for  
capitalized items. (Utilities & Acct.)

Per Staff 1,379  
Per Company 0

To capitalize labor expenses  
associated with tap fees. (Acct.)

Per Staff 375 ( 28)  
Per Company 0 0

To adjust accumulated depreciation for  
depreciation expense adjustment.  
Depreciation for capitalized items  
are included in this adjustment.  
(Utilities & Acct.)

Per Staff 2,784  
Per Company 0

To adjust Cash Working Capital for  
items which correct the books. (Acct.)

Per Staff ( 1,844)  
Per Company 0